RAILROAD STOCKS AS INVESTMENTS

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The ideal investment, it is needless to say, is that which represents a maximum return with a minimum of risk. This, I believe, is at the present time, and probably will be for some time to come, represented by stocks in the solider railway companies. It is true that industrial and some other securities yield, on the average, a higher interest return, but this, as is usually true, is offset by a correspondingly greater risk. This is not losing sight of the fact that in recent times some industrial stocks, especially the preferred stocks in some of the larger corporations, have offered a return both high and uninterrupted. But it is to be recalled that even the best of the industrials are of comparatively recent origin and that the larger part of the industrial securities now on the market have come into existence in a period which has been for this country, and for the world generally, one of almost uninterrupted prosperity. A *continuum* of such prosperity it would be folly to expect. In a large way the seven fat and the seven lean years have alternated since the beginning of trade. The most of our industrials have yet to undergo a prolonged period of depression, such as this country saw from 1893 to 1897 and from 1873 to 1877.

On the other hand, some of our larger railway systems have passed through both of these periods unscathed, and at least one of these systems, the Pennsylvania, has been continuously paying dividends on its stock for upward of sixty years. In the depression of 1893-97 nearly one-third of the railway mileage of the country passed into the hands of the receivers, including great systems like the Reading, the Baltimore & Ohio, Erie, Southern Railway (Richmond Terminal), the Wabash, Union Pacific, Northern Pacific and the Atchison. This was an appalling list of failures, and should not lightly be forgotten. But it is to be remarked that the depression of 1893 followed the great era of rail-

road expansion in America, which came in a period of long and unbounded prosperity, almost identical to that which we have witnessed within the last twelve or thirteen years. It was almost inevitable that such a period must have involved overbuilding and expansion beyond the resources of the country.

It is scarcely probable that the next period of depression will involve our railways to an equal extent. Practically without exception these failures represented a great scandal, a history of disgraceful stock watering or stock jobbing, and a shame to American railroading. Four of these failures were, in fact, due to the evil influence and criminal practices of one man. Our railway managers have learned well in the dear school of experience, and it is a notable fact that several of these systems, which a few years ago were in the hands of receivers, are to-day among the solidest and best-managed properties in the country and better able than many others to weather a storm.

In the terse language of the street, our railways "have had theirs." Our industrials have not. This is an item to consider.

Moreover, the country has now grown up to its railways, so that in the past ten years there has been a comparatively slight expansion of actual mileage, and especially in the West where the last depression was most severely felt, business and trade are in a far better position than twenty years ago. Still further, as will be seen, present economic tendencies are in the direction of strengthening precisely the section which then presented the greatest weakness. It seems altogether probable, so far as it is humanly possible to forecast the future, that our railways present on the whole the safest of the larger fields of investment.

It is to be noted, also, that railway stocks have tended, especially within the past ten years, to pass more into the hands of the smaller investors. A rather unsatisfactory census of railway shareholders made a few years ago showed between three and four hundred thousand names. The Pennsylvania Railroad, for example, alone has upward of fifty or sixty thousand stockholders, nearly one-half of whom are women. This census probably by no means represented the actual figures, many of the shares being held by brokers or trustees for a number of individuals. It is likely that, all told, the railways belong to upward of half a million active owners, and if to this be added the number of individual bond-

holders, this figure would probably lie between one and two millions.

This is a remarkable showing, and with this growth has come a far larger sense of responsibility on the part of railway managers toward the investing public. Dishonesty has been largely, though not wholly, eliminated, and our railways are, for at least the larger part, exceptionally well and conservatively managed properties. So great is the present volume of railway securities, amounting now to fourteen or fifteen billions, that it would be a national menace as well as a national disgrace if the facts were other than as here represented.

Accepting, then, that railway shares present a relatively high degree of security, we may ask as to the return. Nominally the return is not high. Railway shares fluctuate widely in value, but taken year in and year out it may be said that the total of railway shares now on the market sell for somewhere near their nominal, or par, value. The average return on the better class of railway bonds is not much over 4 per cent., and the average dividend on the shares is rather less than this.

But this situation is brought about by the fact that a considerable proportion of the shares bears no dividends, yet these non-dividend shares command ordinarily an absurd and usually entirely fictitious price, ranging from twenty to fifty dollars per share and even more. Actually the return on solid and seasoned dividend-paying shares has ranged within the last few years around an average of from 4½ to 5 per cent. In the panic of 1907 the average dividend on twenty standard shares was a little over 7 per cent. When stocks rule very high, as in 1906, this average may fall considerably below 4 per cent.

This wide variation in actual return, and in the price of securities, was unaccompanied by any corresponding variation in the actual value of the properties. The panic of 1907 was not followed by prolonged depression; it seemed rather a financial and banking spasm than a broad economic crisis, and the recovery therefrom was correspondingly rapid. Only a few badly managed and badly financed properties actually went into the hands of the sheriff, and comparatively few dividends had to be reduced. Some of the reductions, likewise, represented rather commendable caution than actual necessity. It is precisely because of these wide fluctua-

tions, which are recurrent and in a vague way periodic, that the railway shares in their present solid position represent an especially inviting field to those who are willing to give to their investing a little careful consideration and forethought.

Below is given a list of a dozen of the best railway shares with their wider fluctuations within the past ten years. Beginning from a relatively low level it will be noted that within this period there have been three broad "swings": a noteworthy rise extending into 1902, followed by a correspondingly heavy fall; then another prolonged rise to near the close of 1906, followed by another slump culminating in the late panic; and, finally, a third rise extending to the fall of 1909. Individually, the variations in price were as follows:

	Low. 1900.	High. 1902.	Low. 1903-4.	High. 1905-6.	Low. 1907-8.	High. 1909.
N. Y. & New Haven...	207	255	185	216	127	174
New York Central	125	168	112	167	89	147
Pennsylvania	124	170	110	148	103	151
Reading	15	78	37	164	70	173
Lackawanna	171	297	230	560	369	680
C. & N. W............	150	271	153	249	[1]126	198
St. Paul	108	198	133	199	[1]93	163
Illinois Central	110	173	125	184	116	162
Louis. & Nash.........	68	159	95	157	85	162
Atchison	18	96	54	110	66	125
Union Pacific	44	133	65	195	100	219
Great Northern	144	203	160	348	[1]107	157
Average	107	191	121	224	122	209

It will be seen that these twelve standard securities rose in two years from an average value of $107 per share to $191 per share, then declined within a year to an average of $121 per share; then rose again in eighteen months to almost double this figure; that they declined in the panic to $122 per share and then recovered within less than two years to an average of $209 per share.

Taken as a whole, there was throughout these ten years a tendency toward a steady increase in dividends, which was further enhanced by the frequent issue of "rights" to the purchase of stock at much below the market figure. It is evident, then, that

[1]Ex. valuable "rights."

in spite of these wide fluctuations even the more careless of investors, buying, as is the habit of careless investors, when prices have risen and are generally high and enthusiasm at a maximum, would have suffered no very serious loss. On the contrary, they would have done fairly well. To the more cool-headed investor who abstained from purchasing when the outlook was most roseate and enthusiasm rife, and who had the courage, for it takes courage, to buy when the sky was blackest and the nerves of the strongest were shaken, these very fluctuations offered a great opportunity. Had he, further, pursued a consistent policy of selling out his stocks after a long rise, and repurchased them only after a long fall, his reward would have been large.

Simple as such a plan may appear, it is evident that there are few who are able to follow it. If there were many the opportunity would not exist. In point of fact, it seems human nature to believe that when stocks have gone down they will "go further," and, correspondingly, that when they have had a great rise they will "go higher." If it were not for this human infirmity Wall Street would not bear the evil reputation that in many quarters it does and parenthetically, it would scarcely exist. The business of "Wall Street," that is, of the men who make a business of buying and selling stocks, is to get them as cheaply as possible and market them at the highest figure obtainable. It is a common impression that these "kings of Wall Street" pile up in this process enormous fortunes and that the toll they thus exact is heavy. Neither idea is particularly true. The number of fortunes that have been made solely or chiefly through speculation in Wall Street is amazingly small. These men, whose names are fairly well known, often make enormous winnings, but they also endure heavy losses. They are gamblers, and not merchants.

Another prevalent idea is that the rise and fall of Wall Street prices is fairly regular. The figures given above, for the last ten years, would readily give support to this belief. In reality it is quite unfounded. A still more inveterate notion is that the "bull," or buyer for the rise, always has the best of it—that is, that the general tendency of prices through a long period is to higher and higher levels.

There is absolutely nothing in the course of stock prices within the last forty years to sustain this view. But few of the stocks

in the current lists go much back of this, but this was probably equally true in the previous forty years.

It will be well for the investor to fix the facts firmly in his mind. Since 1870 the United States have enjoyed a period uninterrupted by any serious disturbing influences, like the Civil War. Beginning, then, from this time, there have been one short and one very long interval of rising prices; one short and one very long period of falling prices. Following the outburst of activity and speculation at the close of the Civil War, prices in 1870 were at a relatively high level. There followed seven years of drastic decline, culminating, not in the panic of 1873, but four years later. Then came, from 1877 to 1881, the most remarkable rise in values which this country ever saw. In this brief time Dun's standard list of sixty rails showed a rise of over 400 per cent. on the average. From the high level reached in 1881 stocks underwent a long, irregular decline, reaching bottom in the panic of 1893, and then, after a brief rebound, falling again to the same levels in 1896—that is, through a period of fifteen years. They did not again reach the high levels of 1881 until an even twenty years thereafter. Then from 1896 ensued the long rise which reached its highest point in 1906, though on the rebound from the recent panic stocks reached in August, 1909, very near the same high level, some, as is always the case, going much higher than in 1906, while others had nothing like such a rise. Counting to the latter date, the last period of rising and high prices has extended over thirteen years.

It will be seen, therefore, that the periods of rise and the periods of fall were about equally balanced, and that in point of time, the chronic "bull" and the chronic "bear" would have fared about equally well. The lesson is fairly obvious.

The most interesting thing about this showing is that the shorter but heaviest rise followed the shorter but heaviest fall, and the long fall was followed by a rising period of nearly equal length. And just as the fall from 1881 to 1896 was nothing like so heavy as from 1870 to 1877, so the rise from 1896 to 1909 was nothing like so heavy as the rise from 1877 to 1881—roughly, about 200 per cent., as against 400 per cent. in 1881.

Definitively, then, there is no such thing as a "cycle" in stock prices, no way of mechanically forecasting the future. The "twenty-year period" of business activity marked by the prolonged

disturbances of 1837 and 1857 was rudely broken by the panic of 1873. It seemed re-established in the period culminating in the panic of 1893, only to be broken again by the panic of 1907.

The intelligent investor, looking not only to fixed and nominal return from dividends, but likewise toward possible profits from buying when stocks have had a prolonged fall and selling them again after a prolonged rise, will study, rather, the underlying conditions. These are by no means easy to discern, but in looking back over the period under view it will be found that there was at least one factor so prominent that it might almost be called predominating. That is the course of commodity prices. Following the high prices which obtained after the Civil War, which reached their apex in about 1866, there was a long and violent fall extending to about 1877, then an equally violent rebound running into the early eighties, but very short-lived. From the end of 1882 to the end of 1896 commodity prices showed an almost uninterrupted fall, which was especially violent in the eight years following 1888. Then came an equally sharp rebound to about 1902, and it has since continued, though very slowly, upward. It is extremely instructive to note that, in a broad way, prices of standard rails tended to follow much the same course.

If now we look into the fundamental conditions determining the cost of commodity prices, we shall note that, broadly, these fluctuations were world-wide, and, roughly speaking, this can only reflect changes in the relative volume of the world's money. The quantity theory of money is not to be taken without reserve, but it is certainly very striking that in the period following the Civil War the nations tended more and more toward the adoption of a gold standard, while the world's production of gold tended rather to decline. A general appreciation of the exchange value of gold seemed almost inevitable. Then, beginning in the early nineties, while few new nations were added to the gold standard users, the production of gold began to rise by leaps and bounds. From an average production of not much over a hundred millions per year it has risen to well over $400,000,000 in the last three or four years.

The result has been an increase in the known and visible stock of the world's gold money (though by no means of the world's currency as a whole) by at least 50 or 60 per cent. in ten or twelve years. With no very marked increase in the demand, there has

been an enormous increase in the supply. It seems almost inevitable then that the exchange value of gold should fall, and, consequently, that the nominal price of commodities should rise.

It would be absurd to consider this factor alone in the future of commodity prices, and hence on the theory here developed, of the prices of railway shares. But if the production of gold should continue in the same heavy volume, and, still more, if it should show a further increase, it seems almost inevitable that commodity prices would rise further and hence, though probably not in the same degree, that railway shares would tend to high prices.

It is further to be observed that commodity prices in the sixties continued to rise long after gold production had begun to fall sharply; and, correspondingly, commodity prices continued to fall in the early nineties after gold production had more than doubled. In other words, it seems as if the effect continues long after the cause has ceased to operate. It seems, then, as if we may fairly anticipate that commodity prices will continue to rise for a number of years, even though the production of gold should fall off. And on the same reasoning it seems as if we might expect that the prices of shares would, in the absence of any decisive change in conditions, likewise tend to maintain, or return to, high levels.

But if all this should prove true, it is very likely that share prices would continue to show something of the same violent fluctuations that they have in the last eight or ten years. This seems to follow inevitably from a rapidly augmenting and, at the same time, depreciating currency. A depreciating currency means a corresponding rise in the nominal value of all kinds of real property, which tends naturally to promote the gambling mania, and especially land speculation and the like. The result is land booms and wild building booms such as preceded the panic of 1907 and were again in full blast by the end of 1909. In other words, crises and panics tend to be violent and recurrent, but short-lived.

If, then, present underlying conditions should not vitally alter, the intelligent investor may buy stocks in full confidence after a violent fall, with the pretty certain assurance that we shall not, for a time at least, see a return of the prolonged depression in values such as was characteristic of the decades prior to the present. The prophets of an economic crisis in 1913 are of the machine

variety who seem to endeavor to pantagraph the future from the past.

On the other hand, if the reasoning here employed be sound, it seems likely that the intelligent investor may, after a long rise, part with his stocks at good profit in fair confidence that he will be able to get them back in a year or two at much lower levels.

What should he buy? The maximum of safety, it is hardly needful to remark, is in the standard dividend-paying rails. It is nevertheless a curious and somewhat discreditable fact that there is a far wider fluctuation, with an almost irreducible minimum, in the more worthless class of non-dividend common shares, like the common shares in fantastically over-capitalized companies such as the Erie, Southern Railway, Wabash, Rock Island and their like. What is still more curious is an almost greater element of safety. There seems to be among these "cats and dogs" almost a lower limit to their price. Even with the apparently certain prospect of a receivership in 1908, Erie common still sold for $12 a share. Of course, in actual receiverships this minimum may be very much reduced. But even within the year Erie common was selling for $36 per share—a rise of 200 per cent.

What is still more curious, these for the most part valueless securities may generally be purchased much nearer the bottom and sold much nearer the top than the high-priced dividend-payers. The reason for this is that in a long slump they continue their decline for some time after the high-priced rails have reached rock-bottom, and, conversely, they generally continue their rise for some time after the high-priced rails have reached their apex price. It used to be, indeed, a by-word that great activity in Erie after a long rise was a signal that the show was over.

The explanation for this paradoxical condition involves a curious bit of psychology. Apparently the first comers, when Wall Street drums are beating and its flags flying, is a fairly solid investment class, who, while they usually pay high prices for their purchases, take the stocks home and put them away. Following these will be a class of Doubting Thomases, most firmly convinced at the eleventh hour, but tending to confound cheapness with price per share. They will look askance at Union Pacific at $200 per share and paying 5 per cent. solidly at this figure, but they will pay $40 or $50 per share for another stock that is paying nothing and with

little prospects of ever paying anything, save in the minds of the boomers of the Street.

When now a stringency comes or fright ensues, the stocks for which there is always a market at some price are the high-priced rails, and it is these which are usually the first to be thrown overboard. A large operator who could not sell a large line of Southern Railway common without absolutely smashing the market in that stuff could probably sell twenty or forty times as much Union Pacific on a sacrifice of five or ten points. So it is that the low-priced stocks generally trail after the better class both in the rise and in the fall.

But even among the standard securities it will be noted that after a long fall some stocks will rise much higher and more rapidly than others. Thus, for example, in the recovery from the last panic Southern Pacific, Union Pacific, Atchison and Reading rose from 100 to 150 per cent., while solid, well-managed stocks like Northern Pacific, Great Northern, Pennsylvania and Chicago & Northwestern rose only about 50 or 60 per cent. It will be asked, how is one to discriminate?

Practically speaking, for the average individual there is no possible way. Values often have little weight. The percentage of rise and fall in a given stock depends largely on the activity and financial position of the people who are ordinarily its heaviest holders. Or, again, in the hands of a clever manipulator, a stock may be put through great paces, as recently in the rise of a well-known railway stock from a little over $20 per share following the panic to over $90 a share a year and a half later.

There is one admirable rule, and that is to put your eggs in as many baskets as possible. It is far better to have ten shares each in ten stocks than 100 shares in one stock. If the amount to be invested can be divided by twenty it is still better. Then if any "sky-rocketing" of a stock is to go on, one at least stands a chance of participating a little, while the element of risk from unexpected developments or disasters in a single property is correspondingly reduced.

Inside information is, as a rule, the most misleading that can be had, and is almost invariably distributed at the wrong time. There is one simple method of determining the general attitude of the managers of a property toward their own stock, and that is by

noting the percentage of gross earnings applied to maintenance. These figures are reported to the Interstate Commerce Commission and are printed from month to month by most of the financial journals.

For the rest, if the predominating influences which determine the general course of stock prices have here been correctly gauged, it follows that if we are to see a still further rise in commodity prices and a corresponding rise in the value of real property, in other words, a still further depreciation in the purchasing power of the dollar, the railway companies which will derive the most benefit will be those which have large outside possessions in farm lands, coal properties, timber, iron ore and the like. For this reason it seems almost a certainty that, other conditions being equal, stocks like the Canadian Pacific, Northern Pacific, Great Northern, Southern Pacific, Reading, Lackawanna, Lehigh and the like should in the next ten years undergo a much greater appreciation in price than those of companies doing a simple, common carrier business.

This suggestion should not, however, imply the purchase of these stocks at high prices, for there is no reason whatever to suppose that they should be any less subject to wide fluctuations than other stocks. On the contrary, precisely because their speculative possibilities are likely to attract purchasers, thus creating a broad market for the manipulators and professional boomers, they are likely to undergo perhaps even heavier slumps than stocks whose value is more easily calculable, and which therefore lend themselves less to rainbow prophecies.